

Internal Revenue Service
memorandum

CC:TL-N-8747-91
Br4:KAAqui

date: AUG 28 1991

to: District Counsel, Hartford CC:HAR

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED] v. Commissioner
Docket No. [REDACTED]

Our response to your request for informal tax litigation advice of July 18, 1991, in the above referenced matter was communicated to Michael Breton of your office by telephone shortly after receipt. Notwithstanding, events subsequent to that date require a more detailed explanation of our current litigating position.

ISSUE

Whether backpay received in satisfaction of a judgment under Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000 et. seq., (Title VII) constitutes damages received on account of personal injuries under section 104(a)(2) of the Code.

FACTUAL BACKGROUND

Petitioner was a member of a class of black and Hispanic males who brought suit under Title VII and the U.S. Constitution alleging disparate impact in the testing of applicants for firefighter positions with the City of [REDACTED], Connecticut. The trial court found for plaintiffs and subsequently entered an order granting as relief backpay and seniority. The term "backpay" was defined as:

(a) the sum of the value of all regular and overtime wages, fringe benefits, pension benefits, and all other benefits to which firefighters are entitled under applicable union contracts, including all increments, together with interest and "frontpay" for presently qualified candidates until the date of hire;

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(b) reduced by the sum of amounts earned or earnable with reasonable diligence and amounts of any welfare or unemployment compensation received.

A Special Master appointed by the court issued a report finding that the total monetary award to be in the amount of \$ [REDACTED], of which \$ [REDACTED] represented "backpay net of pension contributions and reduced by interim earnings and welfare and unemployment compensation benefits." The remainder, \$ [REDACTED] represented "damages compensating plaintiffs for injury, other than lost wages, of having been victims of discrimination."

Pursuant to the schedule of payments, petitioner received in [REDACTED], backpay of \$ [REDACTED] and damages in the amount of \$ [REDACTED]. Petitioner failed to file a return for [REDACTED] and the Service issued a statutory notice of deficiency wherein the amount of the backpay was treated as gross income. Petitioner now seeks to exclude the backpay from gross income pursuant to section 104(a)(2) and on the basis of recent appellate opinions.

DISCUSSION

In Rev. Rul. 72-341, 1972-2 C.B. 32, the Service published its position that back pay received under Title VII was a substitute for wages the victim of discrimination would have earned and is therefore includible in gross income. Several courts reached the same conclusion. Watkins v. United States, 80-1 U.S.T.C. ¶ 9362 (Ct. Cl. 1980); Hodge v. Commissioner, 64 T.C. 616, 619 (1975). See also Coats v. Commissioner, T.C. Memo. 1977-407. See further non tax cases Johnson v. Harris County Flood Control District, 869 F.2d 1565, 1580 (5th Cir. 1989), cert. denied, _____ U.S. _____, 110 S. Ct. 718 (1990); Sears v. A.T. & S.F. Railway, 749 F.2d 1451, 1456 (10th Cir. 1984), cert. denied, 471 U.S. 1099 (1985); Melani v. Board of Education, 652 F. Supp. 43, 48 (S.D. N.Y. 1986), aff'd without pub. opinion, 814 F.2d 653 (2d Cir. 1987); Curl v. Reavis, 608 F.Supp. 1265, 1269 (W.D. N.C. 1985). Cf. Bowman v. United States, 824 F.2d 528 (6th Cir. 1987) (back wages paid in settlement of Title VII action should be allocated for FICA purposes to periods in which wages would have been earned).

In Rickel v. Commissioner, 900 F.2d 655(3d Cir. 1990), rev'g in part, 92 T.C. 510 (1989), the Third Circuit held that back pay was but a measure of the personal injury suffered by a victim of age discrimination. The Court of Appeals for the

Sixth Circuit reached the same conclusion in Pistillo v. Commissioner, 912 F.2d 145 (6th Cir. 1990), rev'g T.C. Memo. 1989-829. This rationale was expanded to cover backpay received under Title VII in Burke v. Commissioner, 929 F.2d 1119 (6th Cir. 1991). The Tax Court in Downey v. Commissioner, 97 T.C. No. 10 (July 31, 1991), reversed its prior holdings on this issue and aligned itself with the Third and Sixth Circuits. See also Keller v. Commissioner, T.C. Memo. 1991-373. Furthermore, the Court of Appeals for the Ninth Circuit, in a non-tax case, cited Rickel and Pistillo with approval in determining that "economic" damages received for age discrimination are not subject to federal and state income taxes and FICA taxes. Redfield v. Insurance Co. of North America, ___ F.2d ___ (9th Cir. Aug. 6, 1991).

The government has filed a petition for a writ of certiorari from the decision of the Sixth Circuit in Burke, supra, on the grounds that it constitutes a clear conflict with Thompson v. Commissioner, 866 F.2d 709 (4th Cir. 1989) (back pay awarded under Title VII and Equal Pay Act is not excludible). Therein, the government has taken the position that first, back pay does not constitute legal damages and that second, employment discrimination does not constitute a personal injury within the meaning of section 104(a)(2).

When the government files a petition for a writ of certiorari with the Supreme Court, it is our litigation policy to avoid settlement initiatives in similar cases because of the substantial likelihood that such petition will be granted. This policy applies with equal force to cases arising in circuits where precedent is adverse to the Service. After such petition is granted, it is our policy to refrain from compromise of similar cases in any circuit because of the nationwide and retroactive application of Supreme Court decisions.


Thus, pending resolution by the Supreme Court, the Service will continue to assert nationally that back pay awards constitute wages from which appropriate amounts must be withheld for income and social security tax purposes.

If you have any further questions concerning this matter,
please contact Mr. Keith A. Aquí at FTS 566-3308.

Sincerely,

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By:


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